

Message Text

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PAGE 01 BRASIL 05879 01 OF 02 161200Z
ACTION EB-07

INFO OCT-01 ARA-10 ISO-00 SP-02 USIA-06 AID-05 NSC-05
EPG-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 COME-00
CIAE-00 DODE-00 PM-04 H-01 INR-07 L-03 NSAE-00
PA-01 PRS-01 INT-05 IGA-02 OPIC-03 XMB-02 /088 W
-----087951 161215Z /41

R 152030Z JUL 77
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 2792
INFO AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

LIMITED OFFICIAL USE SECTION 1 OF 2 BRASILIA 5879

EO 11652 NA
TAGS: EMIN EINV BR
SUBJECT: CARAJAS

REF: BRASILIA 3689

SUMMARY. OREN HUDSON, US STEEL HEAD IN RIO, IN RECENT MEETING WITH
CONSUL GENERAL PROVIDED US STEEL'S VERSION OF ITS DECISION TO
WITHDRAW FROM CARAJAS REPORTED REFTEL. ACCORDING TO HUDSON,
THE WITHDRAWAL WAS FORCED BY CVRD, SPEAKING
THROUGH MINISTER UEKI, BECAUSE OF US STEEL REFUSAL TO MAKE
FIRM FINANCIAL COMMITMENT FOR PROJECT IMPLEMENTATION IN
ABSENCE OF FUNDAMENTAL AGREEMENTS ON ISSUES RELEVANT TO
PROJECT'S VIABILITY. DIVORCE DISCUSSIONS WERE AMICABLE AND
SETTLEMENT SIGNED JUNE 15 WAS IN GENERAL SATISFACTORY TO
US STEEL. IT CALLS FOR SALE OF US STEEL AMZA SHARES TO CVRD
FOR \$49.6 MILLION REPRESENTING ORIGINAL INVESTMENT PLUS MODEST
INTEREST. US STEEL HAS OPTION TO RETURN BUT NO PRESENT
EXPECTATIONS. HUDSON DOUBTS THAT CARAJAS WILL NOW CONTINUE,
AT LEAST NOT ON ORIGINAL SCHEDULE, BECAUSE OF LIMITED CVRD
RESOURCES AND PROBABLE DIFFICULTIES INTERESTING OTHER FOREIGN
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PAGE 02 BRASIL 05879 01 OF 02 161200Z

INVESTORS. FOLLOWING IS CONSUL GENERAL'S REPORT:

1. OREN HUDSON CALLED JULY 7 TO BRING ME UP TO DATE ON LATEST
DEVELOPMENTS ON THE CARAJAS PROJECT. HE FIRST SUMMARIZED
EVENTS EARLIER THIS YEAR AS US STEEL CAME UNDER INCREASING
PRESSURE FROM CVRD TO MAKE A COMMITMENT OF THREE OR FOUR
HUNDRED MILLION DOLLARS TO CONTINUE WITH CARAJAS. HE

RECALLED THE US STEEL POSITION THAT IT WAS UNWILLING TO MAKE SUCH A COMMITMENT UNTIL FOUR BASIC ISSUES WERE RESOLVED IN AT LEAST GENERAL TERMS. THESE ISSUES WERE (1) MANAGERIAL STRUCTURE OF AMZA, (2) FOREIGN PARTICIPATION, (3) MARKETING ARRANGEMENTS FOR CARAJAS IRON ORE AND RL FINANCING. WITHOUT FURTHER PROGRESS IN THESE AREAS US STEEL DID NOT FEEL JUSTIFIED IN COMMITTING MORE MONEY TO THE PROJECT.

2. THE MATTER CAME TO A HEAD IN MARCH WHEN UEKI MET WITH US STEEL OFFICIALS IN NEW YORK. US STEEL NEGOTIATORS WERE PREPARED TO OFFER A NEW PROPOSAL FOR CONDITIONAL COMMITMENT BASED UPON AGREEMENTS RE MANAGEMENT AND SUBJECT TO FUTURE RESOLUTION OF OTHER ISSUES. HOWEVER, UEKI CUT THE GROUND FROM UNDER THEM BY ISSUING A VIRTUAL ULTIMATUM TO THE EFFECT THAT THEY EITHER MAKE AN IMMEDIATE COMMITMENT OR SELL THEIR AMZA SHARES TO CVRD. NOT BEING WILLING TO MAKE THE COMMITMENT, US STEEL OPTED FOR THE DIVESTITURE UNDER UEKI'S WARNING THAT GOB WOULD OTHERWISE REVOKE US STEEL'S CARAJAS CONCESSIONS.

3. IN SUBSEQUENT NEGOTIATIONS, US STEEL OBTAINED A SETTLEMENT AGREEMENT BASED UPON REPAYMENT OF THE HISTORIC DOLLAR VALUE OF ITS ORIGINAL INVESTMENT, \$40.9 MILLION, PLUS 6 PERCENT TAX-FREE INTEREST COMPOUNDED FROM THE DATE OF THE INVESTMENT. THE FINAL SUM AMOUNTS TO ABOUT \$49.6 MILLION, ALL REPATRIATABLE IN DOLLARS. WHILE THIS DOES NOT REPRESENT WHAT WOULD HAVE BEEN A REASONABLE RETURN IN COMPARISON WITH OTHER POSSIBLE LIMITED OFFICIAL USE

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PAGE 03 BRASIL 05879 01 OF 02 161200Z

INVESTMENTS, I.E., OPPORTUNITY COST, HUDSON INDICATED THAT US STEEL IS SATISFIED.

4. AGREEMENT ON THESE TERMS WAS SIGNED ON JUNE 15 WHEN US STEEL EFFECTIVELY CEASED TO BE AN ACTIVE PARTNER IN AMZA. THE TWO PARTIES ARE NOW WORKING OUT THE DETAILS OF THE SPLIT, WHICH IS TO BE FINALIZED FOUR MONTHS AFTER THE DATE OF SIGNING. DETAILS INCLUDE A SCHEME FOR MINIMIZING THE TAX IMPACT THROUGH ORGANIZATION OF A TRANSITIONAL MERIDIONAL SUBSIDIARY CALLED FERNOR, WHICH WILL RECEIVE US STEEL'S AMZA EQUITY FOR SUBSEQUENT RESALE TO CVRD.

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PAGE 01 BRASIL 05879 02 OF 02 161151Z

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LIMITED OFFICIAL USE SECTION 2 OF 2 BRASILIA 5879

5. ANOTHER CONDITION AGREED TO BY CVRD WAS TO GRANT US STEEL THE OPTION TO RE-ENTER THE PROJECT AT A LATER DATE ON THE SAME CONDITIONS AS OTHER FOREIGN PARTICIPANTS HUDSON DID NOT INDICATE THAT US STEEL ANTICIPATES GETTING BACK INTO THE PROJECT IN THE FORESEEABLE FUTURE BUT IS HAPPY TO HAVE THE POSSIBILITY KEPT OPEN.

6. WITH US STEEL OUT OF THE PICTURE FOR AT LEAST THE TIME BEING, HUDSON DOUBTS THAT THE CARAJAS PROJECT WILL MOVE FORWARD ON THE ORIGINAL TIMETABLE. HE DOUBTS THAT CVRD HAS THE RESOURCES TO PROCEED ON ITS OWN ESPECIALLY GIVEN ALTERNATIVE IRON ORE RESOURCES IN BRAZIL FROM WHICH ITS AVAILABLE RESOURCES WOULD YIELD HIGHER RETURNS. HE ALSO FEELS THAT THE PROSPECTS OF OTHER FOREIGN PARTICIPATION HAVE BEEN HURT BY THE UNHAPPY OUTCOME OF US STEEL'S EFFORTS. THAT EXPERIENCE WILL CREATE DOUBTS ABROAD ABOUT THE FEASIBILITY OF DOING BUSINESS WITH CVRD ON SUCH A COMPLICATED VENTURE AND OTHER PROSPECTIVE INVESTORS ARE LIKELY TO INSIST UPON THE SAME CONDITIONS AS US STEEL (I.E., RESOLUTION OF THE FOUR BASIC ISSUES CITED ABOVE) BEFORE MAKING FIRM FINANCIAL COMMITMENTS. FINALLY,
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PAGE 02 BRASIL 05879 02 OF 02 161151Z

US STEEL'S WITHDRAWAL REMOVES NOT ONLY A MAJOR SOURCE OF INVESTMENT FUNDS BUT ALSO AN IMPORTANT CUSTOMER.

7. CONSIDERING THE TERMS OF THE DIVORCE GENERALLY REASONABLE, HUDSON ATTRIBUTES THIS AND THE ABSENCE OF POLEMICAL CVRD PUBLICITY AGAINST US STEEL TO THE BRAZILIAN DESIRE TO KEEP US STEEL IN THE WINGS AND ALSO TO RESTRAIN ANY TEMPTATION THE COMPANY MIGHT HAVE TO BAD-MOUTH CVRD IN THE INTERNATIONAL BUSINESS COMMUNITY, THUS DETERRING OTHER INVESTORS. IN FACT, HUDSON SAID, US STEEL IS REFRAINING FROM PUBLICIZING ITS

SIDE OF THE CONTROVERSY AND BLACKENING CVRD'S NAME, THOUGH HE SAID THEY CANNOT DECLINE TO TELL THE FACTS AS THEY SEE THEM IF ASKED BY OTHER INTERESTED FIRMS. AND IN THIS CONNECTION, HE MENTIONED A RECENT CONVERSATION HE HAD HAD WITH A REPRESENTATIVE OF NIPPON STEEL, WHO HAD BEEN KEENLY INTERESTED IN THE US STEEL EXPERIENCE. US STEEL IS OF COURSE INFLUENCED IN ITS APPROACH TO THE MATTER BY THE FACT THAT IT HAS OTHER INTERESTS IN BRAZIL THAT COULD BE JEOPARDIZED IF CVRD AND THE MINISTRY OF MINES SHOULD BE ANTAGONIZED.

8. HUDSON BELIEVES THAT THE CVRD TREATMENT OF US STEEL IN THIS MATTER HAS PRODUCED SOME ADVERSE REACTIONS ALREADY IN BRAZIL. HE HAS HEARD, HE SAID, THAT PRESIDENT GEISEL IS UNHAPPY OVER THE PERFORMANCE OF FERNANDO ROQUETTE REIS AND THAT WITHIN THE CVRD ITSELF THERE IS SOME CRITICISM OVER THE WAY THE CURRENT MANAGEMENT PROCEEDED IN THE AFFAIR. IN THE BUSINESS COMMUNITY AT LARGE, HE THINKS THERE IS SOME APPREHENSION BY BRAZILIANS THAT THE US STEEL CASE WILL HAVE AN ADVERSE EFFECT ON FOREIGN INVESTORS. HUDSON DOES NOT HOWEVER SEE ANY IMMEDIATE IMPACT ON OTHER MINERALS PROJECTS, INCLUDING THOSE UNDER CVRD.

9. WITH THE COLLAPSE OF ITS CARAJAS INTERESTS, HUDSON SAYS LIMITED OFFICIAL USE

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PAGE 03 BRASIL 05879 02 OF 02 161151Z

US STEEL WILL NOW BE REMOVING MOST OF ITS ELEVEN EXECUTIVES IN BRAZIL. HE EXPECTS TO BE AROUND FOR AT LEAST SIX MONTHS BUT DOES NOT BELIEVE THAT HIS PRESENCE COULD IN THE LONG RUN BE JUSTIFIED BY US STEEL'S MANGANESE SUBSIDIARY AND IS APPARENTLY MAKING CONTINGENCY PLANS TO LEAVE WITH HIS FAMILY WITHIN THE NEXT YEAR.
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